No. 12193

# In the United States Court of Appeals For the Ninth Circuit

MARICOPA PACKING COMPANY,

*Appellant,*

vs.

DONALD B. SHORTRIDGE, Trustee in Bankruptcy of the Estate of Northern Meat Company, Inc., Bankrupt,

*Appellee.*

## OPENING BRIEF OF APPELLANT

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## SUBJECT INDEX

## TABLE OF CASES AND AUTHORITIES CITED

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### STATEMENT RELATIVE TO JURISDICTION

This is an appeal from an order entered by the United States District Court for the District of Arizona, in a controversy arising in a proceeding in bankruptcy. The amount involved exceeds five hundred dollars.

Jurisdiction of the District Court is conferred by Section 2 of the Bankruptcy Act (Section 11, Chapter 2, Title 11 U. S. C.) and the jurisdiction of the United States Court of Appeals is invoked under Section 24(a) of the Bankruptcy Act (Section 47, Chapter 4, Title 11 U. S. C.)

## STATEMENT OF THE CASE

Appellee, Trustee in Bankruptcy of Northern Meat Company, Inc., a bankrupt, filed with the Referee a "Petition for Finding of Fact" (T. R. 31-34) in which he alleged:

(a) March 1, 1948, Maricopa Packing Company commenced an action in the Superior Court of Maricopa County against Northern Meat Company, Inc., to recover five hundred ninety-four and 12/100 dollars. (T. R. 31.)

(b) March 25, 1948, a writ of garnishment issued out of such state court in said cause, and was served upon First National Bank of Arizona, Phoenix, where Northern Meat Company, Inc., had deposits aggregating one thousand seventeen and 37/100 dollars. Such funds were sequestered by the writ and impressed with a lien in favor of Maricopa Packing Company. (T. R. 32.)

(c) July 2, 1948, within four months of the date of the levy of such writ of garnishment, Northern Meat Company, Inc., was adjudicated a bankrupt. (T. R. 32.)

By such petition, the Trustee prayed that the Referee find affirmatively that Northern Meat Company, Inc., was actually insolvent on March 25, 1948, when its funds were sequestered by the writ of garnishment. (T. R. 33.)

If Northern Meat Company, Inc., was actually insolvent when said writ of garnishment was served, then under Section 67(a)(1) of the Bankruptcy Act (Section 107, Chapter 7, Title 11 U. S. C.) the lien of the writ must fail, it being conceded that the writ was served within four months of the date of the filing of the petition in bankruptcy.

Maricopa Packing Company appeared in opposition to the Trustee's petition (T. R. 3) and evidence was adduced before the Referee. (T. R. 3-31.) The Referee found as a fact that Northern Meat Company, Inc., was insolvent on the date the writ of garnishment was issued and served, (T. R. 35) and his order was affirmed, upon review by the District Judge, (T. R. 45) and this appeal perfected by the creditor Maricopa Packing Company. (T. R. 46-47.)

## SPECIFICATION OF ERRORS

1. The District Court erred in affirming the order of the Referee, because the purported finding of fact by the Referee to the effect that the bankrupt was insolvent on March 25, 1948, is not supported by, and is contrary to, the evidence.

2. The District Court erred in affirming the order of the Referee, because all of the evidence before the Referee, taken in the light most favorable to the Trustee, establishes that the bankrupt was solvent on March 25, 1948.

3. The District Court erred in affirming the order of the Referee, because at the hearing before the Referee upon the petition of the Trustee, the Referee admitted in evidence, over the objection of appellant, the testimony of one Laird A. Racey and the financial statement prepared by Racey on September 20, 1948, as evidence of the value of the assets of the bankrupt on March 25, 1948. Such evidence was clearly incompetent.

4. The District Court erred in affirming the order of the Referee, because the finding of fact made by the Referee is contrary to the averment contained in the "Petition for Finding of Fact" filed by the Trustee,

in that the balance sheets of the bankrupt for the 24th and 25th days of March, 1948, attached to said petition and made a part thereof, show affirmatively that the assets of the bankrupt exceeded its liabilities on those dates.

5. The District Court erred in failing and refusing to enter an appropriate order to the effect that this appellant has a good and valid prior lien under the writ of garnishment issued out of the Superior Court of Maricopa County, Arizona, on March 25, 1948, upon the funds of the bankrupt on deposit with the First National Bank of Arizona, Phoenix.

## SUMMARY OF ARGUMENT

1. The statute relating to invalidity of liens against property of debtor, obtained by legal process within four months before the filing of the petition in bankruptcy, applies only if the debtor was insolvent when the lien was acquired. If the debtor was not then insolvent, the lien is valid although it was obtained within the four months period.

2. The test in determining the solvency of a corporate debtor is whether its assets, fairly valued, exceed its liabilities, disregarding liability to stockholders.

3. There is no evidence of the insolvency of the debtor upon the date the writ of garnishment was levied.

## ARGUMENT

**1. The Statute Relating to Invalidity of Liens Against Property of Debtor, Obtained by Legal Process Within Four Months Before the Filing of the Petition in Bankruptcy, Applies Only if the Debtor was Insolvent When the Lien was Acquired. If the Debtor was Not Then Insolvent, the Lien Is Valid Although it was Obtained Within the Four Months' Period.**

In *Taubel-Scott-Kitzmiller Co. vs. Fox,* 264 U. S. 426, 44 S. Ct. 396, 68 L. Ed. 770, it is said:

> "For the statute does not, as a matter of substantive law, declare void every lien obtained through legal proceedings within four months of the filing of the petition in bankruptcy. The lien may be valid, because the debtor was, in fact, solvent at the time the levy was made."

To the same general effect, see *Liberty National Bank vs. Bear,* 265 U. S. 365, 44 S. Ct. 499, 68 L. Ed. 1057.

**2. The Test in Determining the Solvency of a Corporate Debtor is Whether Its Assets, Fairly Valued, Exceed Its Liabilities, Disregarding Liability to Stockholders.**

Section 67-d-(1) of the Bankruptcy Act (Section 107-d-1, Chapter 7, Title 11, U. S. C.) thus defines insolvency:

> " . . . a person is 'insolvent' when the present fair salable value of his property is less than the amount required to pay his debts."

In speaking of a somewhat similar provision in the Bankruptcy Act, the Court of Appeals for the Eighth Circuit, in *Arkansas Oil & Mining Co. vs. Murray Tool & Supply Co.,* 127 F. 2d 564, said:

> "Insolvency, under the act here involved, must be determined according to whether or not the agreegate of a person's property at a fair valuation is sufficient to pay his debts. There is no specific finding as to the value of the aggregate of appellant's assets, either at the time of the commission of the alleged acts of bankruptcy, or at the time of filing the involuntary petition. True, there is a conclusion embodied in the referee's so-called findings, but it ought specifically to appear that this conclusion is based upon the essential elements constituting insolvency."

The capital stock of a corporation is not to be considered as a liability in determining its solvency.

*Stitzer Hotel Co. vs. Beyer* (C. C. A. 3) 55 F. 2d 620;

*Curtis vs. Dade County Security Company* (C. C. A. 5) 30 F. 2d 325;

*In Re Cleveland Discount Company* (D. C. Ohio) 9 F. 2d 97.

**3. There Is No Evidence of the Insolvency of the Debtor Upon the Date the Writ of Garnishment was Levied.**

It is submitted that there is no proof in the record to the effect that on March 25, 1948, the "fair salable value of the debtor's property was less than the amount required to pay its debts."

The "book values" (T. R. 29-31) showed the debtor to be solvent on that date.

The Trustee attempted to prove insolvency by the testimony of an accountant who admitted, in both the written report that he filed with the Referee (T. R. 26-28) and in his testimony, (T. R. 10) that "I have made no attempt to appraise the assets."

While the proceedings before the Referee were somewhat informal, they were reported and tran-

scribed, and it is believed that the following excerpts may be of some assistance to the court in understanding the theory of the Referee and the Trustee, which seems to have been that because some of the assets were sold months after the garnishment lien had attached, for very low prices, such fact in and of itself established the debtor's insolvency at the date the writ was issued and served.

During the testimony of the witness, Laird A. Racey, the following transpired:

> "A. In explaining that I would like to refer back to the report, the last sentence on Page 1 of the report. I stated I have made no attempt to appraise the assets but have adopted those values which, in my opinion, most clearly reflect their true realizable value. Upon final disposition the Chevrolet truck and large items of equipment did not realize anything over and above the loans against them. It is my belief that the best measure of realizable value of any item is the amount realized at a sale. I have therefore used these figures in determining the realizable value of the truck and large items of equipment.
>
> "MR. RHUE: You know when that truck was disposed of?
>
> "THE WITNESS: I do not have the exact date, it was sold at an auction subsequent to March 24th.

"MR. RHUE: This Northern Meat Company was a going concern on the 24th of March?

"A. That is right.

"MR. RHUE: And that was an asset in use with the company at that time?

"A. Yes, sir.

"MR. RHUE: We object to this evidence, your Honor, as being immaterial here. It was a going concern, it had the assets and if it had been sold subsequent thereto that can be no evidence of value on the 24th of March.

"MR. SHORTRIDGE: We submit the amount on the books is not what we are getting. The question is what that truck would have realized had it been sold on March 25th.

"THE REFEREE: The market value.

"MR. SHORTRIDGE: Yes.

"THE REFEREE: The objection is overruled.

"MR. RHUE: If your Honor please, that truck at that time when it was in use by the company and a going concern was certainly more valuable than subsequently when it went out of business.

"THE REFEREE: I don't think so, the market value would be exactly the same.

"MR. RHUE: Furthermore, the estimate is made here by the auditor, he isn't qualified to

make such an appraisal. I object to any testimony he puts on as an appraiser, he is not qualified to appraise these properties at that time.

"THE REFEREE: He is giving testimony upon which he based his conclusion and it is up to me to pass on the weight or whether it is right or not.

"MR. SHORTRIDGE: I submit this is quite commonly submitted by certified public accountants. He is only presenting these figures for what they are worth.

"THE REFEREE: Go ahead.

"MR. SHORTRIDGE: I am further prepared to show, your Honor, if necessary in this thing the truck was later sold at a loss.

"THE REFEREE: You are the trustee?

"MR. SHORTRIDGE: Yes.

"THE REFEREE: You make that statement as a trustee, as an officer of this court?

"MR. SHORTRIDGE: I will make the statement, a letter was received by me from the Assistant Manager of the First National Bank, August 25th, 1948, in which it was stated that the bank received the truck on May 26th, 1948, the amount of lien at that time—

"MR. RHUE: Just a minute, that is subsequent to March 24th.

"THE REFEREE: I will consider that.

"MR. RHUE: It would be a new asset after that.

"MR. SHORTRIDGE: That goes to the weight, not the admissibility. If this truck were bought on March 27th it would have stronger weight than if sold in May.

"THE REFEREE: Go ahead. In other words, the truck was sold in May at a loss.

"MR. SHORTRIDGE: That is correct.

"THE REFEREE: All right, as an officer of the Court here you make that statement. I will take it for what it is worth. Anything else?

"MR. RHUE: I will object to this evidence because it is just the opinion of the bank, it is not worth anything, it is not evidence.

"MR. SHORTRIDGE: I don't know, they state in this letter they sold it at a loss. It says, 'The public auction was held on June 26th, 1948, at the Arcade Garage and was purchased by the First National Bank for $615.96.'

"THE REFEREE: Did you discuss this with the bank?

"MR. SHORTRIDGE: No, I requested a letter.

"THE REFEREE: Go ahead.

"MR. SHORTRIDGE: 'The truck was sold July 27th, 1948, to the Arizona Truck Sales and Service for $575.52, from which was deducted the

storage of $24.48, leaving a net of $551.04. The bank made no profit on this sale, in fact, we lost money. Trusting this information is sufficient, Very truly yours.' Signed by C. W. Morris, Assistant Manager.

"THE REFEREE: Do you want to raise the—

"MR. RHUE: It is not admissible as to value.

"MR. SHORTRIDGE: If this is not admissible as to the value of the car, then what evidence is admissible?

"THE REFEREE: I will consider. Proceed.

"MR. SHORTRIDGE: You have here listed a number of assets, a Sanitary Scale, a Vaughn meat saw, a Chotillon beam scale and so on with an offset to the conditional sales contract leaving a balance of nothing for unsecured creditors. How did you arrive at that figure?

"A. That item and also the walk-in freezing box above here were subject to conditional sales contracts held by the First National Bank. Upon final disposition they did not realize anything over and above the amount owed by them.

"MR. RHUE: When was that final disposition?

"A. It was by court order.

"MR. RHUE: Do you recall the approximate date?

"A. Around September 1st, I believe.

"MR. RHUE: Of this year?

"A. That is right.

"MR. RHUE: I object there as to this evidence not being permissible as of value of the 24th of March.

"THE REFEREE: That was August 14, 1948.

"MR. SHORTRIDGE: Again we say this evidence should be considered and the question here is one of weight and not admissibility.

"THE REFEREE: All right, proceed.

"Q. (By MR. SHORTRIDGE): You have addition of small tools and equipment, no estimate available, in other words, you estimate—

"A. In preparation of the statement I have tried to be as conservative as possible and in this particular item I could not ascertain that it was included on the appraisal sheet, nor could I find any means whatsoever of determining what the value might be, therefore, I have used the full book value, although it is my opinion they probably would not have produced that much.

"Q. The various small item of office equipment, $20, where did you get that?

"A. For lack of any other figure that is the figure that was used on the appraisal for the purpose of the trustees.

"Q. (By MR. RHUE): What appraisal are you referring to?

"A. I believe Mr. Green's.

"MR. RHUE: When?

"A. On August 23rd, 1948.

"MR. RHUE: Not as of March 24th, 1948?

"A. As far as I know there was none available as of March 24th, 1948, had there been I would have used it." (T. R. 10-15.)

"MR. RHUE: A used truck right now would cost more than a new truck.

"THE REFEREE: Not now, there has been a terrific change in property this year, the bottom has dropped out.

"MR. RHUE: That was not the condition on March 24th.

"THE REFEREE: Oh, yes, it was, it has been the condition since early this year. That has been the history of the bankruptcy here. I think the Court can take judicial notice that that condition has changed the last six months. Go ahead, anything further?" (T. R. 21-22.)

"Q. (By MR. RHUE): Did you see this property on the 24th of March?

"A. I did not.

"Q. Did you see it at any time?

"A. I did not.

"MR. RHUE. We object to any evidence offered here as to the value of this property.

"THE REFEREE: Objection overruled.

"Q. (By MR. RHUE): Now in this procedure the books didn't reflect any depreciation or any other charges other than shown in your report?

"A. That is true.

"Q. And according to the books the values of the properties as of March 24th is $7800?

"A. That is true.

"Q. And that the liabilities were approximately $1700 less?

"A. That is correct.

"Q. Now while you have set up here and shown that some of these assets were held under conditional sales contracts, isn't it possible that property could have been sold on that date or for a time very near that date for something realized over and above the balance due on the contracts?

"A. As a matter of opinion I do not believe I am qualified to answer that.

"Q. But the company would have equities in there to the extent of what they had paid on that property?

"A. That is right." (T. R. 23).

"Q. If this company were to go to the bank on the 24th day of March and ask for a loan in

that statement they would set up their book values as you have set them up here?

"A. That is a matter of opinion.

"Q. Their assets and liabilities would have been set up as in your accounting here?

"A. I am not sure how they would set it up, that is how I would set it up.

"THE REFEREE: You always make a statement to the bank and the bank cuts it about half.

"MR. RHUE: Still, Your Honor, it is on the basis of the figures they submit.

"THE REFEREE: In this case, are you through?

"MR. SHORTRIDGE: I tried to get Mr. Green, the appraiser, he was unable to make it. I can get him on some other day if the Referee desires, he has examined those things.

"THE REFEREE: I am ready to rule on it. In this case there is no question in my mind at all that this company has been insolvent from the very beginning, certainly on the 25th of March. I think you creditors knew it and run an attachment on whatever there was and I would, therefore, find that the company was actually insolvent at the time your garnishment was levied. I will make a finding that it was actually insolvent on that date." (T. R. 25-26).

To appellant it seems that all of the above testimony was admitted in clear violation of the rule laid down in *Liberty National Bank vs. Bear,* 265 U. S. 365, 44 S. Ct., 499, 68 L. Ed. 1057, wherein it is said:

> "Nor does the fact that the sales of the partnership and individual properties, made some months later by the trustee, did not realize enough to pay either the debts of the partnership or the debts of the individual partners, respectively, establish the insolvency of the partners at the time the lien was obtained."

To the same effect, see *In Re Cleveland Discount Company* (D. C., Ohio) 9 F. 2d 97, 101.

That the witness Racey was not qualified to express any opinion as to the value of the assets of the debtor corporation on March 25, 1948 seems clear from the decision of the Circuit Court of Appeals for the Third Circuit, in *Stitzer Hotel Company vs. Beyer,* 55 F. 2d 620, 622.

## CONCLUSION

There may be a serious question as to the jurisdiction of the District Court to enter any order in the premises. Perhaps the controversy should have been determined in the state court, which had at least the constructive possession of the *res* under the writ of garnishment prior to and at the time of the adjudication of the debtor as a bankrupt. This thought seems to underlie the decision in *W. F. Pigg & Son vs. U. S.* (C. C. A. 10) 81 F. 2d 334.

Of course, it is true that in Arizona the funds sequestered by the writ of garnishment are, from the very moment of the service of the writ, in the control of the court that issued the writ. *Gillespie Land & Irrigation Company vs. Jones,* 63 Ariz. 535, 164 P. 2d 456.

Because of the stipulation of the parties, however (T. R. 33) " . . . that the issue as to whether the now bankrupt was insolvent at the time the writ of garnishment was granted, should be resolved by the Referee in Bankruptcy", appellant is probably precluded from challenging the jurisdiction of the District Court upon the ground indicated.

It is, however, most respectfully insisted that there is no basis in the evidence for the order of the Referee

or its affirmance by the District Judge, and that the same should be reversed.

Respectfully submitted,

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